

ORIGINAL

OPEN MEETING ITEM

COMMISSIONERS  
JEFF HATCH-MILLER - Chairman  
WILLIAM A. MUNDELL  
MIKE GLEASON  
KRISTIN K. MAYES  
GARY PIERCE



ARIZONA CORPORATION COMMISSION



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AZ CORP COMMISSION  
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DATE: JANUARY 29, 2007

DOCKET NOS: W-02860A-06-0002 and W-02860A-05-0727

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane Rodda. The recommendation has been filed in the form of an Opinion and Order on:

NACO WATER COMPANY  
(RATES/FINANCE)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

FEBRUARY 7, 2007

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

FEBRUARY 13, 2007 and FEBRUARY 14, 2007

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Secretary's Office at (602) 542-3931.

Arizona Corporation Commission  
DOCKETED

JAN 29 2007

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BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**

JEFF HATCH-MILLER, Chairman  
WILLIAM A. MUNDELL  
MIKE GLEASON  
KRISTIN K. MAYES  
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF  
NACO WATER COMPANY, LLC FOR A RATE  
INCREASE.

DOCKET NO. W-02860A-06-0002

IN THE MATTER OF THE APPLICATION OF  
NACO WATER COMPANY, LLC FOR  
APPROVAL OF FINANCING.

DOCKET NO. W-02860A-05-0727

DECISION NO. \_\_\_\_\_

**OPINION AND ORDER**

DATE OF HEARING:

November 8, 2006

PLACE OF HEARING:

Tucson, Arizona

ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

APPEARANCES:

Bonnie O'Connor, Southwestern Utility  
Management, on behalf of Naco Water  
Company, LLC; and

Kevin Torrey, Staff Attorney, Legal  
Division, on behalf of the Utilities  
Division for the Arizona Corporation  
Commission.

**BY THE COMMISSION:**

\* \* \* \* \*

Having considered the entire record herein and being fully advised in the premises, the  
Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

**FINDINGS OF FACT**

1. On October 19, 2005, Naco Water Company, LLC ("NWC" or "Company") filed with  
the Commission an application for the approval of long-term debt from the Arizona Water  
Infrastructure Finance Authority ("WIFA").

1           2.       On January 3, 2006, NWC filed an application for a permanent rate increase with the  
2 Commission. In 2005, the Company had filed for an emergency rate increase which was granted in  
3 Decision No. 67984 (May 10, 2005). Decision No. 67984 required NWC to file a permanent rate  
4 case as soon as it was able, but no later than May 31, 2006.

5           3.       On February 2, 2006, the Commission's Utilities Division Staff ("Staff") filed a letter  
6 indicating the Company's rate application was not sufficient pursuant to A.A.C. R14-2-103.

7           4.       On February 9, 2006, the Company filed additional information pursuant to Staff's  
8 request.

9           5.       On March 2, 2006, Staff filed a letter indicating the Company's rate application was  
10 sufficient, and classifying the Company as a Class C utility.

11          6.       By Procedural Order dated March 13, 2006, the Commission established procedural  
12 guidelines and set the matter for hearing on September 14, 2006.

13          7.       Pursuant to the March 13, 2006, Procedural Order, the Company mailed notice of the  
14 hearing to its customers on April 5, 2006.

15          8.       By letter dated June 6, 2006, NWC filed a request to suspend the time clock. NWC  
16 reported that the consulting engineering firm that was assisting it with its loan request with WIFA  
17 had experienced difficulty responding to Staff's data requests because new engineering issues  
18 continued to arise. In addition, the Company stated the delay had been exasperated by the discovery  
19 of a sulfate problem allegedly caused by a nearby Phelps Dodge mine. According to the Company,  
20 its need for financing increased from approximately \$500,000 to \$2.5 million.

21          9.       NWC and Staff participated in a telephonic procedural conference on June 21, 2006.  
22 At that time, NWC agreed to update the test year to year-end 2005.

23          10.       By Procedural Order dated June 28, 2006, new procedural guidelines were established  
24 and the hearing was continued until November 8, 2006. In addition, the June 28, 2006, Procedural  
25 Order found that good cause existed to suspend the time clock imposed by A.A.C. R14-2-103.

26          11.       On August 7, 2006, Staff filed Motions to Consolidate the rate and finance  
27 applications.

28          12.       The applications were consolidated by Procedural Order dated August 23, 2006.

1           13.    On September 1, 2006, Staff filed the Direct Testimony of Jeffrey Michlik and  
2 Dorothy Hains.

3           14.    On October 2, 2006, the Company filed a Response to Staff's Direct Testimony.

4           15.    On October 23, 2006, Staff filed the Surrebuttal Testimony of Mr. Michlik and Ms.  
5 Hains.

6           16.    On November 1, 2006, the Company filed a Response to Staff's Surrebuttal  
7 Testimony.

8           17.    The hearing convened before a duly authorized Administrative Law Judge as  
9 scheduled on November 8, 2006, at the Commission's Tucson offices.

10          18.    NWC is a limited liability company that provided water service during the test year to  
11 approximately 366 customers in Cochise County. NWC has three water systems. One area includes  
12 the Town of Naco; known as the Naco Town System and this system serves approximately 285  
13 customers. The other two systems are located approximately three miles to the east of the Town of  
14 Naco and known as the Bisbee Junction and Bisbee Highway systems. The Bisbee Junction System  
15 serves approximately 71 customers, and the Naco Highway System serves approximately 10  
16 customers. None of the systems are interconnected.

17          19.    NWC's current permanent rates were set in Decision No. 60500 (November 25, 1997).  
18 In the Company's 2005 emergency rate case, the Commission approved a surcharge of \$6.50 per  
19 meter on residential connections.

20          20.    In reviewing the Commission's records, Staff found that the Commission had received  
21 six complaints in the past three and half years, which complaints involved water outages, low-  
22 pressure, billing problems and meter placement. The Commission received three opinions opposing  
23 the current rate increase.

24          21.    As adjusted by Staff, in the test year ended December 31, 2005, NWC experienced a  
25 \$22,553 operating loss on adjusted total revenues of \$159,429.

22. In its application, NWC proposed increasing its annual operating revenues by \$230,143, from \$159,429<sup>1</sup> to \$389,572, a 144.35 percent increase. The Company proposed operating expenses of \$188,430, which would yield Operating Income of \$201,142, a 31.53 percent return on an adjusted original cost rate base ("OCRB") of \$637,938.

23. Staff recommends total annual revenue of \$285,711, a \$126,282, or 79.21 percent, increase over adjusted test year revenues of \$159,429. Staff's recommended revenue level would yield Operating Income of \$103,729, a 16.26 percent rate of return on an adjusted OCRB of \$637,938.

24. NWC's present and proposed rates and charges, and Staff's recommended rates and charges are as follows:

	<u>Present Rates</u>	<u>Proposed Rates Company</u>	<u>Proposed Rates Staff</u>
<u>MONTHLY USAGE CHARGE:</u>			
5/8" x 3/4" Meter	\$16.43	\$56.00	\$29.00
3/4" Meter	16.43	56.00	29.00
1" Meter	31.48	63.00	56.00
1 1/2" Meter	41.43	69.00	74.00
2" Meter	48.30	74.00	87.00
3" Meter	160.00	180.00	180.00
4" Meter	260.00	285.00	285.00
6" Meter	510.00	640.00	600.00

COMMODITY RATES:

Per 1,000 gallons

5/8 inch meter (Residential)			
From 1 to 10,000 gallons	\$2.83	N/A	N/A
Over 10,000 gallons	4.18	N/A	N/A
From 1 to 3,000 gallons	N/A	\$4.80	N/A
From 3,001 to 10,000 gallons	N/A	5.80	N/A
Over 10,000 gallons	N/A	6.75	N/A
From 1 to 3,000 gallons	N/A	N/A	\$4.10
From 3,001 to 9,000 gallons	N/A	N/A	6.15
Over 9,000 gallons	N/A	N/A	7.38

5/8 inch meter (Commercial)

<sup>1</sup> Staff's adjusted test year revenues.

1	From 1 to 10,000 gallons	2.83	N/A	N/A
	Over 10,000 gallons	4.18	N/A	N/A
2	From 1 to 3,000 gallons	N/A	4.80	N/A
	From 3,001 to 10,000 gallons	N/A	5.80	N/A
3	Over 10,000 gallons	N/A	6.75	N/A
	From 1 to 9,000 gallons	N/A	N/A	6.15
4	Over 9,000 gallons	N/A	N/A	7.38
5	$\frac{3}{4}$ inch meter (Residential)			
6	From 1 to 10,000 gallons	\$2.83	N/A	N/A
	Over 10,000 gallons	4.18	N/A	N/A
7	From 1 to 3,000 gallons	N/A	\$4.80	N/A
	From 3,001 to 10,000 gallons	N/A	5.80	N/A
8	Over 10,000 gallons	N/A	6.75	N/A
9	From 1 to 3,000 gallons	N/A	N/A	4.10
	From 3,001 to 9,000 gallons	N/A	N/A	6.15
10	Over 9,000 gallons	N/A	N/A	7.38
11	$\frac{3}{4}$ inch meter (Commercial)			
	From 1 to 10,000 gallons	2.83	N/A	N/A
12	Over 10,000 gallons	4.18	N/A	N/A
	From 1 to 3,000 gallons	N/A	\$4.80	N/A
13	From 3,001 to 10,000 gallons	N/A	5.80	N/A
14	Over 10,000 gallons	N/A	6.75	N/A
	From 1 to 9,000 gallons	N/A	N/A	6.15
15	Over 9,000 gallons	N/A	N/A	7.38
16	1 inch meter (Residential and Commercial)			
17	From 1 to 10,000 gallons	\$2.83	N/A	N/A
18	Over 10,000 gallons	4.18	N/A	N/A
	From 1 to 3,000 gallons	N/A	\$4.80	N/A
19	From 3,001 to 10,000 gallons	N/A	5.80	N/A
	Over 10,000 gallons	N/A	6.75	N/A
20	From 1 to 18,000 gallons	N/A	N/A	6.15
21	Over 18,000 gallons	N/A	N/A	7.38
22	1 $\frac{1}{2}$ inch meter (Residential and Commercial)			
23	From 1 to 10,000 gallons	\$2.83	N/A	N/A
	Over 10,000 gallons	4.18	N/A	N/A
24	From 1 to 3,000 gallons	N/A	\$4.80	N/A
	From 3,001 to 10,000 gallons	N/A	5.80	N/A
25	Over 10,000 gallons	N/A	6.75	N/A
26	From 1 to 30,000 gallons	N/A	N/A	6.15
27	Over 30,000 gallons	N/A	N/A	7.38

28

2 inch meter (Residential and Commercial)

From 1 to 10,000 gallons	\$2.83	N/A	N/A
Over 10,000 gallons	4.18	N/A	N/A
From 1 to 3,000 gallons	N/A	\$4.80	N/A
From 3,001 to 10,000 gallons	N/A	5.80	N/A
Over 10,000 gallons	N/A	6.75	N/A
From 1 to 35,000 gallons	N/A	N/A	6.15
Over 35,000 gallons	N/A	N/A	7.38

3 inch meter (Residential and Commercial)

From 1 to 10,000 gallons	\$2.83	N/A	N/A
Over 10,000 gallons	4.18	N/A	N/A
From 1 to 3,000 gallons	N/A	\$4.80	N/A
From 3,001 to 10,000 gallons	N/A	5.80	N/A
Over 10,000 gallons	N/A	6.75	N/A
From 1 to 100,000 gallons	N/A	N/A	6.15
Over 100,000 gallons	N/A	N/A	7.38

4 inch meter (Residential and Commercial)

From 1 to 10,000 gallons	\$2.83	N/A	N/A
Over 10,000 gallons	4.18	N/A	N/A
From 1 to 3,000 gallons	N/A	\$4.80	N/A
From 3,001 to 10,000 gallons	N/A	5.80	N/A
Over 10,000 gallons	N/A	6.75	N/A
From 1 to 150,000 gallons	N/A	N/A	6.15
Over 150,000 gallons	N/A	N/A	7.38

6 inch meter (Residential and Commercial)

From 1 to 10,000 gallons	\$2.83	N/A	N/A
Over 10,000 gallons	4.18	N/A	N/A
From 1 to 3,000 gallons	N/A	\$4.80	N/A
From 3,001 to 10,000 gallons	N/A	5.80	N/A
Over 10,000 gallons	N/A	6.75	N/A
From 1 to 300,000 gallons	N/A	N/A	6.15
Over 300,000 gallons	N/A	N/A	7.38

SERVICE LINE AND METER

INSTALLATION CHARGES:

(Refundable pursuant to A.A.C. R14-2-405)

5/8" x 3/4" Meter	\$400.00	\$450.00	\$450.00
3/4" Meter	400.00	475.00	475.00

1	1" Meter	500.00	550.00	550.00
1	1 1/2" Meter	715.00	775.00	775.00
2	2" Meter	1,305.00	1,375.00	1,375.00
2	3" Meter	1,860.00	1,975.00	1,975.00
3	4" Meter	2,860.00	3,040.00	3,040.00
4	6" Meter	5,275.00	5,635.00	5,635.00
5	<u>SERVICE CHARGES:</u>			
6	Establishment	\$25.00	\$35.00	\$30.00
6	Establishment (After Hours)	30.00	45.00	40.00
7	Reconnection (Delinquent)	25.00	35.00	30.00
7	Reconnection (After Hours)	N/A	45.00	40.00
8	Meter Test (If Correct)	30.00	45.00	30.00
9	Deposit	*	*	*
9	Deposit Interest	*	*	*
10	Reestablishment (Within 12 Months)	**	**	**
10	Reestablishment (After Hours)	**	**	**
11	NSF Check	15.00	20.00	20.00
12	Deferred Payment per month	1.5% of	1.5% of	1.5% of
12		outstanding bal.	outstanding bal.	outstanding bal.
13	Meter Reread (If Correct)	\$10.00	\$15.00	\$15.00
14	Moving Customer Meter at Customer request per rule R14-2-405B	Cost	Cost	Cost

16 \* Per Commission rule A.A.C. R-14-2-403(B).

17 \*\* Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).

18 25. The Company requested authorization to incur long-term debt in the amount of  
 19 \$2,457,119 from WIFA. The Company proposes to use the loan proceeds to finance upgrades  
 20 needed to reduce water loss, develop a new water source and complete well site improvements and  
 21 miscellaneous compliance upgrades. A summary of the Company's proposed projects and Staff's  
 22 recommendations follows:

23 ...

24 ...

25 ...

26 ...

27 ...

28



Company Priority Ranking	Project Description	Company Cost Estimate	Staff Recommended Amounts
	<b>Water Loss Projects:</b>		
1	Naco Town System -- Service Line Connections	\$401,792.98	\$401,792.98
1	Bisbee Junction System -- Replace Main on Bisbee Junction Road	26,072.10	26,072.10
3	Bisbee Junction System -- Distribution Piping	644,744.10	644,744.10
	<b>New Source Projects:</b>		
1	Southern Upper San Pedro River Hydrologic Assessment	\$74,960.00	0
2	Bisbee Junction System -- Well Site # 7 Well Installation and Source Approval <sup>2</sup>	55,419.70	0
2	Bisbee Junction System -- Well Site #7 Plant construction	104,057.20	0
2	Water Main Extension to Naco Highway System and Bisbee Junction from New Well No. 7	1,008,635.80	0
	<b>Compliance Projects:</b>		
3	Naco Town System -- Well Site # 2 Renovations and well abandonment	\$36,947.60	\$10,000 <sup>3</sup>
3	Naco Town System -- Well Site #6 Renovations	27,055.50	0
3	Naco Highway System -- Well Site #3 Renovations & Well Abandonment	35,389.40	5,000 <sup>4</sup>
3	Bisbee Junction System -- Well Site #5 Well Abandonment	9,900.60	0
3	Bisbee Junction System -- Well Site #4 Renovations and Well Abandonment	32,144.50	0
	<b>Total</b>	<b>\$2,457,119.48</b>	<b>\$1,087,609.18</b>

26. NWC obtained a WIFA loan in 1998 for the purpose of upgrading the Naco Town Site system. That project was not completed because during the time the Company requested the loan and the time construction commenced, prices of materials had increased substantially and NWC was not

<sup>2</sup> Well No. 7 would be a newly drilled well to replace current Well No. 4.

<sup>3</sup> Staff recommends that only the pressure tank and chlorinator installation be completed at this time. Staff's adjusted amount for this work is \$10,000, which includes \$9,000 for a 2,000 gallon pressure tank and \$1,000 for a 50 gallon chlorinator.

<sup>4</sup> Staff recommends that only the pressure tank installation be completed at this time. Staff estimates \$5,000 to complete.

1 able to complete the project. In connection with its current financing request, WIFA provided a  
2 technical assistance grant for engineers to estimate what it would take to finish the project. The  
3 Company's consulting engineers estimate the cost to complete the Naco Town System project to be  
4 \$401,792.98.

5 27. NWC operates four wells, numbered 2, 3, 4 and 6. Wells Nos. 2 and 6 serve the Naco  
6 Township and are interconnected. Wells Nos. 2 and 6 are not experiencing production problems.

7 28. While the engineers were conducting their study, NWC learned that sulfates are  
8 creating problems with some of NWC's wells. The Company states that Well No. 4, which is the  
9 only well serving the Bisbee Junction System, has had severe production problems. In one two  
10 month period, NWC had to haul water at a cost of \$15,600. (TR at 13) When Well No. 4 is not  
11 producing, the Company hauls water from Well No. 6. The Company believes that sulfates are  
12 clogging the well casing, and strongly suspects that the mining tailings from a Phelps Dodge mine are  
13 the source of the sulfates. Well No. 3 serves the Naco Highway System. NWC states that it has been  
14 having trouble with sulfates at Well No. 3 as well, although because this well is newer, the sulfates  
15 have not caused the same disruptions as with Well No. 4. (TR at 14)

16 29. NWC asserts that it needs to perform a hydrologic study to determine the extent of the  
17 sulfate problem, and to determine if the sulfates can be traced to Phelps Dodge mining operations.  
18 NWC assumes that if it can demonstrate that Phelps Dodge operations are responsible for the sulfate  
19 problems, Phelps Dodge will help NWC mitigate the problems. Thus, NWC assigns high priority to  
20 the hydrologic study, which its engineers estimate will cost about \$75,000. NWC states that it will  
21 not know whether it would be advantageous to drill Wells Nos. 3 and 4 deeper or relocate these wells  
22 without such study.

23 30. The Bisbee Junction distribution project is needed to upgrade a severely substandard  
24 system. The Bisbee Junction System suffers many breaks because of the substandard materials and  
25 the fact that in many places plastic pipes lie on top of the ground where they are exposed to the  
26 elements. In addition, the Bisbee Junction Road main needs to be replaced as it lies under a gas  
27 line and several inches of concrete that forms the roadway, and subsidence is causing frequent breaks.  
28

1 (TR at 79) Staff believes that replacing the Bisbee Junction Road main would dramatically reduce  
2 the water loss experiences by the Bisbee Junction system. (TR at 91)

3 31. Staff found that the Company's estimates of project costs to be reasonable. (TR at  
4 111) Staff believes that that projects addressing water loss are the most important and deserve  
5 priority. Staff identified projects totaling \$1,087,609.18 that Staff believes deserves funding. To the  
6 extent the WIFA loan would not cover all of the recommended upgrades, Staff recommends that the  
7 Naco Town System Service Line Connection and Bisbee Junction System Main Replacement  
8 projects be given first priority. (Hains Direct at 15) Staff does not believe it is in the best interests of  
9 the Company to approve financing of a new well at this time because there are too many unknowns  
10 about where such well should be located or even if a new well is the best solution to the production  
11 problems plaguing the Bisbee Junction System. (TR at 109-110/ Hains Dir at 15-17)

12 32. Staff recommends approving total revenues of \$285,711. Although Staff appears to  
13 recognize that proposed system upgrades totaling at least \$1,087,609.18 deserve high priority (see  
14 table above), Staff did not recommend authorizing a loan that would be sufficient to complete all the  
15 projects at this time. In determining its recommended revenue requirement and loan authorization,  
16 Staff balanced the need for cash flow to support debt service and the effect on ratepayers. (Michlik  
17 Dir at 11). WIFA requires a Debt Service Coverage ("DSC") of 1.2, and has no stated Times Interest  
18 Earned Ratio ("TIER") requirement. A \$450,000 loan at 5.6 percent, and Staff's recommended  
19 operating income of \$103,729, would produce a TIER of 2.52 and a DSC ratio of 1.20. Similarly, a  
20 \$750,000 loan, at 0 percent interest, and Staff's recommended revenues, the Company would have a  
21 TIER of 6.34 and DSC of 1.20.

22 33. NWC did not dispute any of Staff's adjustments to revenue, expenses or rate base.  
23 The Company is extremely concerned, however, that Staff's recommendation for a rate increase that  
24 would only allow a \$450,000 WIFA loan is completely insufficient to address the on-going and  
25 worsening drinking water supply issues that NWC faces. The Company argues that it is not  
26 guaranteed that WIFA would give the Company a 0 percent loan, and that under Staff's proposal a  
27 \$450,000 loan is completely inadequate to address even the projects that Staff believes should receive  
28 priority. The Company notes that \$750,000 is not enough to do all that the Company believes it must

1 do to improve the systems. The Company understands that the resultant rate increase that would be  
2 necessary to support its loan request would be substantial. Consequently, the Company proposes to  
3 phase-in the rate increase. Under this proposal, rates would only increase as improvements are  
4 completed. According to the Company's plan, if the hydrological study indicates Phelps Dodge is  
5 responsible for the sulfate problem, and Phelps Dodge ultimately contributes funds to resolve that  
6 problem, the Company would not have to draw on loan funds to relocate or re-drill the wells and rates  
7 would not have to increase to support the loan. The Company does not want to have to file multiple  
8 finance or rate applications which it asserts are costly and time consuming.

9       34. Under the Company's proposed rates, the average residential customer, using 6,585  
10 gallons of water would experience a monthly increase of \$48.46, from \$42.73 (including the  
11 surcharge) to \$91.19, a 113.44 percent increase. The median residential customer, using 5,272  
12 gallons per month, would experience an increase of \$44.57, or 114.25 percent, from \$39.01  
13 (including the surcharge) to \$83.58, under the Company proposed rates.

14       35. Under Staff's proposed rates, the average residential customer using 6,585 gallons a  
15 month, would experience an increase of \$20.62, or 48.27 percent, from \$42.73 (including the  
16 surcharge) to \$63.35. The median customer, using 5,272 gallons a month, would experience an  
17 increase of \$16.26, or 41.68 percent, from \$39.01 (including the surcharge) to \$55.27 under Staff's  
18 proposed rates.

19       36. NWC testified that it has \$3,000 in the bank, but it has \$112,000 in Accounts Payable,  
20 \$15,000 of which is owed to WIFA as a result of its current loan. Southwestern Utility Management  
21 ("SUM") manages NWC. SUM has had to provide funds to NWC to meet necessary expenses.

22       37. NWC's owner offered to give the Company to the ratepayers if they would form a  
23 water improvement district. The customers explored the idea, but apparently abandoned it when they  
24 realized that they would be responsible for the debts of the Company. (TR at 64-65)

25       38. NWC has demonstrated a need for all of the proposed projects associated with the  
26 water loss issues; for a hydrological study to determine how to address the need for a new source of  
27 water; and for the compliance related projects, although these have a lower priority than the need to  
28 address water loss and a reliable source for the Bisbee Junction system. NWC has not demonstrated

1 a need to locate a new source at this time. The projects associated with drilling a new well and  
 2 connecting that well to the distribution system can only occur after the hydrologic study, as the  
 3 Company itself recognizes. (Tr. at 46) Even Staff, which does not include finding a new source as a  
 4 high priority, recognizes that the Company needs to investigate and analyze the problems with Well  
 5 No. 4 to provide an adequate production for the Bisbee Junction System. (TR at 117) Relocating a  
 6 well, or wells, will impact the entire distribution system, as mains have to extend to any new well  
 7 site. Given the Company's suspicions about a sulfate plume, it would be premature to replace wells  
 8 without a hydrological study. Thus, we believe that the Company has demonstrated a need for capital  
 9 to complete the following projects, which will result in immediate and necessary benefits to the  
 10 system and its users:

11	Naco Town System	\$401,792.98
12	Bisbee Junction – Replace Main	26,072.10
13	Bisbee Junction Distribution	644,744.10
14	Hydrological Study	74,960.00
15	Well Nos. 2 and 3 upgrades	<u>15,000.00</u>
16	Total	\$1,162,569.18

17 Consequently, we authorize the Company to borrow up to \$1,160,000 from WIFA for a term of 20  
 18 years.

19 39. NWC is in a severely negative financial condition. Any finance authority that we  
 20 approve will need to be supported by a rate increase. We must in this case balance the burden on  
 21 ratepayers with the need to make system repairs.

22 40. Thus, based on the entirety of the record before us, we approve a revenue increase of  
 23 98.6 percent, or \$157,176, which will produce total revenue of \$316,605. This revenue level is  
 24 sufficient to support a WIFA loan of \$1,160,000 at zero percent interest. We will not know the actual  
 25 interest rate of the loan until WIFA has had an opportunity to meet and consider NWC's application.  
 26 We understand that in this case, WIFA could approve an interest rate of between 0 and 5.6 percent.<sup>5</sup>

27 <sup>5</sup> At the time of the Staff testimony, the prime rate was 8 percent. NWC would be entitled to a 70 percent subsidy  
 28 pursuant to WIFA's formula, would yield an interest rate of 5.6 percent. If the prime rate has changed, the maximum  
 interest rate applied to NWC would change as well.

1 To the extent WIFA approves a loan with an interest rate greater than 0 percent, the Company would  
2 only be able to borrow a lesser amount than what we have authorized without filing another rate  
3 case<sup>6</sup>, and would need to prioritize among the system upgrades. <sup>7</sup> Any upgrades not able to be  
4 completed at this time, would not be eliminated, but only deferred.

5 41. Our authorized revenue requirement would increase the median residential bill, with  
6 usage of 5,272 gallons, by \$22.27, from \$39.01 to \$61.28, an increase of 57.08 percent.

7 42. We find Staff's adjustments to rate base and test year Operating Expenses, as set forth  
8 in Mr. Michlik's direct and surrebuttal testimony to be reasonable. Therefore, we find the  
9 Company's OCRB to be \$637,938. The Company's Fair Value Rate Base ("FVRB") is the same as  
10 its OCRB.

11 43. We concur with Staff that in this case, the Company's cash flow needs are more  
12 relevant to the determination of the appropriate revenue requirement than the rate of return on FVRB.  
13 Nonetheless, our authorized revenue requirement would yield a return on FVRB of 21 percent.

14 44. The Arizona Department of Environmental Quality ("ADEQ") has determined that the  
15 Naco Town System and Bisbee Junction System have no major deficiencies and are currently  
16 delivering water that meets water quality standards required by the Arizona Administrative Code.  
17 Title 18, chapter 4. The Naco Highway system is classified as a semi-public system because of its  
18 small number of connections, and is not yet regulated by ADEQ.

19 45. The U.S. Environmental Protection Agency ("EPA") has reduced the arsenic  
20 maximum contaminant level ("MCL") in drinking water from 50 parts per billion ("ppb") to 10 ppb.  
21 The most recent lab analysis indicates that the arsenic levels for NWC's wells is below 5 ppb.

22 46. NWC is not located in any Active Management Area ("AMA") and is not required to  
23 comply with Arizona Department of Water Resources ("ADWR") monitoring and reporting  
24 requirements.

25 47. There are no outstanding Commission compliance issues.

26  
27 <sup>6</sup> The authorized revenue level would support a \$700,000 WIFA loan at an interest rate of 5.6 percent.

28 <sup>7</sup> We find it unfortunate that the customers of NWC were not able to form a water improvement district as we believe that grant money, or other favorable financing opportunities, might be available to a district that would allow the district to make needed system upgrades without as great an impact on ratepayers.

1        48. In the test year, NWC reported 37,292,000 gallons pumped and 28,118,000 gallons  
2 sold, which indicates a water loss of 24.6 percent for the combined system. The Naco Town system  
3 had a water loss of 23.51 percent; the Bisbee Junction System had a 31.39 percent loss; and the Naco  
4 Highway System had a 4.11 percent loss.

5        49. Staff states that non-account water should be 10 percent of less and never more than  
6 15 percent. Staff recommends that the Company reduce its water loss in the Naco Town System and  
7 Bisbee Junction System to 15 percent or less before filing the next rate application. In addition, Staff  
8 recommends that concurrent with the Company filing its next rate application, the Company should  
9 file a plan to reduce its water loss to 10 percent of less. Pursuant to Staff's recommendation, if the  
10 Company finds that the reduction in water loss to less than 10 percent is not cost-effective, the  
11 Company should submit, before filing its next rate application, a detailed cost analysis and  
12 explanation demonstrating why water loss reduction to 10 percent or less is not cost effective.

13        50. Staff states that the Naco Highway and Bisbee Junctions Systems do not have  
14 adequate production or storage capacity to support their existing customer bases, however, the Naco  
15 Town System has adequate production and storage. Staff believes that the Company has several  
16 options available to it to address the deficiency. Staff suggests that the Company could obtain  
17 additional production or storage, or it could interconnect the deficient systems with each other or  
18 adjacent systems. Therefore, Staff recommends that the Company take action to resolve the storage  
19 deficiencies of the Bisbee Junction and Naco Highway Systems prior to filing its next rate  
20 application.

21        51. Staff further recommends that the Company file for Staff's review and certification  
22 within 30 days of the effective date of the Order, as a compliance item in this docket, a list of projects  
23 that it proposes to undertake using the debt authorization amount ultimately approved in this matter.  
24 Staff further recommends that when preparing the above list, the Company shall give priority to  
25 projects that are most effective and cost efficient in addressing the water loss.

26        52. Because an allowance for the property tax expense of NWC is included in the  
27 Company's rates and will be collected from its customers, the Commission seeks assurances from the  
28 Company that any taxes collected from ratepayers have been remitted to the appropriate taxing

1 authority. It has come to the Commission's attention that a number of water companies have been  
 2 unwilling or unable to fulfill their obligation to pay the taxes that were collected from ratepayers,  
 3 some for as many as twenty years. It is reasonable, therefore, that as a preventive measure NWC  
 4 annually file, as part of its annual report, an affidavit with the Utilities Division attesting that the  
 5 company is current in paying its property taxes in Arizona.

### 6 CONCLUSIONS OF LAW

7 1. NWC is a public service corporation pursuant to Article XV of the Arizona  
 8 Constitution and A.R.S. §§ 40-250 and 40-251.

9 2. The Commission has jurisdiction over NWC and the subject matter of the application.

10 3. Notice of the proceeding was provided in conformance with law.

11 4. The rates and charges approved herein are reasonable.

12 5. Staff's recommendations, as set forth in Findings of Fact Nos. 49, 50 and 51 are  
 13 reasonable and should be adopted.

14 6. The financing approved herein is for lawful purposes within NWC's corporate powers,  
 15 is compatible with the public interest, with sound financial practices, and with the proper  
 16 performance by NWC of service as a public service corporation, and will not impair NWC's ability to  
 17 perform the service.

18 7. The financing approved herein is for the purposes stated herein, is reasonably  
 19 necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to  
 20 operating expenses or to income.

### 21 ORDER

22 IT IS THEREFORE ORDERED that the rates and charges set forth below are approved and  
 23 Naco Water Company, LLC shall file on or before February 28, 2007, a tariff that complies with the  
 24 rates and charges approved herein:

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1  
2 MONTHLY USAGE CHARGE:

3	5/8" x 3/4" Meter	\$32.16
4	3/4" Meter	32.16
5	1" Meter	62.50
6	1 1/2" Meter	82.50
7	2" Meter	96.20
8	3" Meter	180.00
9	4" Meter	285.00
10	6" Meter	600.00

11 COMMODITY RATES:

12 Per 1,000 gallons

13	5/8 inch meter (Residential)	
14	From 1 to 3,000 gallons	4.54
15	From 3,001 to 9,000 gallons	6.82
16	Over 9,000 gallons	8.19

17	5/8 inch meter (Commercial)	
18	From 1 to 9,000 gallons	6.82
19	Over 9,000 gallons	8.19

20	3/4 inch meter (Residential)	
21	From 1 to 3,000 gallons	4.54
22	From 3,001 to 9,000 gallons	6.82
23	Over 9,000 gallons	8.19

24	3/4 inch meter (Commercial)	
25	From 1 to 9,000 gallons	6.82
26	Over 9,000 gallons	8.19

27	1 inch meter (Residential and Commercial)	
28	From 1 to 18,000 gallons	6.82
29	Over 18,000 gallons	8.19

30	1 1/2 inch meter (Residential and Commercial)	
31	From 1 to 30,000 gallons	6.82
32	Over 30,000 gallons	8.19

33	2 inch meter (Residential and Commercial)	
34	From 1 to 35,000 gallons	6.82
35	Over 35,000 gallons	8.19

1 3 inch meter (Residential and  
2 Commercial)

3 From 1 to 93,000 gallons 6.82  
4 Over 93,000 gallons 8.19

5 4 inch meter (Residential and  
6 Commercial)

7 From 1 to 150,000 gallons 6.82  
8 Over 150,000 gallons 8.19

9 6 inch meter (Residential and  
10 Commercial)

11 From 1 to 300,000 gallons 6.82  
12 Over 300,000 gallons 8.19

13 SERVICE LINE AND METER

14 INSTALLATION CHARGES:

15 (Refundable pursuant to A.A.C. R14-2-  
16 405)

17 5/8" x 3/4" Meter \$450.00  
18 3/4" Meter 475.00  
19 1" Meter 550.00  
20 1 1/2" Meter 775.00  
21 2" Meter 1,375.00  
22 3" Meter 1,975.00  
23 4" Meter 3,040.00  
24 6" Meter 5,635.00

25 SERVICE CHARGES:

26 Establishment \$30.00  
27 Establishment (After Hours) 40.00  
28 Reconnection (Delinquent) 30.00  
29 Reconnection (After Hours) 40.00  
30 Meter Test (If Correct) 30.00  
31 Deposit \*

32 Deposit Interest \*  
33 Reestablishment (Within 12 Months) \*\*  
34 Reestablishment (After Hours) \*\*  
35 NSF Check 20.00  
36 Deferred Payment per month 1.5% of  
37 outstanding bal.

38 Meter Reread (If Correct) \$15.00  
39 Moving Customer Meter at Customer Cost  
40 request per rule R14-2-405B

\* Per Commission rule A.A.C. R-14-2-403(B).

\*\* Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, use, and franchise tax. Per Commission Rules 14-2-409(D)(5).

IT IS FURTHER ORDERED that the rates and charges approved herein shall be effective for all service provided on and after March 1, 2007.

IT IS FURTHER ORDERED that within 15 days of the effective date of this Order, Naco Water Company, LLC shall notify its customers of the rates and the effective dates approved herein, in a form and manner acceptable to the Commission's Utilities Division Staff.

IT IS FURTHER ORDERED that Naco Water Company LLC is authorized to borrow up to \$1,160,000 from the Water Infrastructure Finance Authority for a term of 20 years, at the interest rate approved by WIFA.

IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon Naco Water Company, LLC's use of the proceeds for the purposes stated herein.

IT IS FURTHER ORDERED that Naco Water Company, LLC is authorized to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

IT IS FURTHER ORDERED that Naco Water Company, LLC shall file with Docket Control as a compliance item in this docket copies of any and all financing documents setting forth the terms and financing within 30 days of obtaining such financing.

IT IS FURTHER ORDERED that within 30 days of the WIFA approval, as a compliance item in this docket, Naco Water Company, LLC shall, file a list of projects that it will undertake consistent with this Decision, using the debt authorization amount approved by WIFA.

IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that concurrent with Naco Water Company, LLC filing its next

1 rate application, it shall file a statement whether water loss has been reduced to 10 percent or less,  
2 and if water loss is still greater than 10 percent for any of its systems, it shall file with such rate case,  
3 a plan to reduce its water loss to 10 percent or less. If Naco Water Company, LLC finds that the  
4 reduction in water loss to less than 10 percent is not cost-effective, it shall submit, before filing its  
5 next rate application, a detailed cost analysis and explanation demonstrating why water loss reduction  
6 to 10 percent or less is not cost effective.

7 IT IS FURTHER ORDERED that to the extent the identified storage deficiencies continue to  
8 exist with the Bisbee Junction and Naco Highway Systems at the time of Naco Water Company,  
9 LLC's next rate case, Naco Water Company LLC shall file with its next rate case, a plan to resolve  
10 such storage deficiencies.

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1 IT IS FURTHER ORDERED that Naco Water Company, LLC shall annually file as part of its  
2 annual report, an affidavit with the Utilities Division attesting that the Company is current in paying  
3 its property taxes in Arizona.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.  
6  
7

8 CHAIRMAN

COMMISSIONER

9  
10  
11  
12 COMMISSIONER

COMMISSIONER

COMMISSIONER

13  
14 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
15 Director of the Arizona Corporation Commission, have  
16 hereunto set my hand and caused the official seal of the  
Commission to be affixed at the Capitol, in the City of Phoenix,  
this \_\_\_\_ day of \_\_\_\_\_, 2007.

17  
18 BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

19  
20 DISSENT \_\_\_\_\_

21  
22 DISSENT \_\_\_\_\_

23 JR

1 SERVICE LIST FOR: NACO WATER COMPANY, LLC  
2 DOCKET NOS.: W-02860A-06-0002 and W-02860A-05-0727

3  
4 Naco Water Company, LLC  
5 Attn: Bonnie L. O'Connor  
6 P.O. Box 85160  
7 Tucson, Arizona 85754  
8  
9 Christopher Kempley, Chief Counsel  
10 LEGAL DIVISION  
11 Arizona Corporation Commission  
12 1200 W. Washington Street  
13 Phoenix, Arizona 85007  
14  
15 Ernest Johnson, Director  
16 Utilities Division  
17 Arizona Corporation Commission  
18 1200 W. Washington Street  
19 Phoenix, Arizona 85007  
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